(1)

Supreme Court, U.S.
FILED

97 2074 MAR 23 1998

OFFICE OF THE CLERK

No.

In The
SUPREME COURT of the UNITED STATES

October Term, 1997

Stephen and Deborah Demarest,
Petitioners,

v.

Rainier Title Insurance Company, a
Washington Corporation,
Respondent

ON PETITION FOR WRIT OF CERTIORARI to the
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

Stephen H. Demarest, *pro se*
Deborah A. Demarest, *pro se*
P O Box 2023,
Friday Harbor, WA 98250
(360) 378-5848

18 pp

Questions Presented for Review

1.

Whether the Ninth Circuit's novel analysis that reliance need not be established as an independent element of bankruptcy fraud conflicts with the common law and the Supreme Court?[1]

2.

Whether the Ninth Circuit's suggestion that the level of reliance is less in a case of non disclosure (ie false pretense) then in a case of affirmative discloure conflicts with the law?[2]

---

1 Cf. "No one, of course, doubts that some degree of reliance is required to satisfy the element of causation inherent in the phrase 'obtained by'" *Field v. Mans*, _US_, 115 S.Ct 437, 238 BCD 231 at 234 (1995).

2 Cf. "[W]e do not mean to suggest that the requisite level of reliance would differ if there should be a case of false pretense or representation . . ." *Field*, at 237, fn. 8.

3.

Whether the Ninth Circuit erred by adopting the reasonable person standard to determine reliance in a case of fraud.[3]

4.

Where the action of the creditor preceded the improper conduct of the debtor, can it be said that the debt was "obtained by" fraud?

---

3 Cf. "As (Prosser and Keaton) points out, the standard is not that of the average reasonable person. It is a more **subjective** standard which takes into account the knowledge and relationship of the parties themselves." ***In Re Kirsh***, 973 F.2d 1454, 1458 (1992) cited approvingly in ***Field v Mans***, _U.S. _, 116 S.Ct. 437 (1995).

Table of Contents

Questions Presented for Review ii

Table of Cited Authorities vi

Citations of Decisions Below 1

Basis for Jurisdiction 3

Applicable Statutes 4

Statement of the Case 5

Argument 9
- Introduction 9
- Reliance Not an Element? 10
- Less Reliance Required for Non Disclosure 13
- Objective or Subjective Standard .. 17
- Obtained By 18

Conclusion 19

Appendix 20
- APPENDIX A - ORDER DETERMINING DEBT NON-DISCHARGEABLE .. 21
- APPENDIX B - JUDGMENT AGAINST DEBORAH A. DEMAREST AND STEPHEN H. DEMAREST 24

APPENDIX C - MEMORANDUM OPINION 25
APPENDIX D - ORDER ON MOTION FOR RECONSIDERATION 45
APPENDIX E - MEMORANDUM (not for publication) 47
APPENDIX F - MEMORANDUM (not for publication) 69
APPENDIX G - ORDER DENYING REHEARING 72

Table of Cited Authorities

28 U.S.C § 523 (a) (2) (A) (1995) 4

Basic Inc. v. Levinson, 485 U.S. 224, 243, 108 S. Ct. 978, 989, 99 l. Ed. 2D 194 (1988) 12

Field v. Mans, _US_, 115 S.Ct 437, 238 BCD 231 at 234 (1995) ..... ii-iii, 10, 12-13, 16-18

In Re Apte, 180 BR 223 (N.D. Calif. 1995) 11

In Re Demarest, 176 B. R. 917 (W. D. Wash., 1995) 1, 11

In Re Kirsh, 973 F.2d 1454 (1992) ..... iii, 15, 17

Citations of Decisions Below

This action began in Bankruptcy Court as an adversary proceeding with a *sua sponte* granting of summary judgment, modified on reconsideration:

September 30, 1994	Order Determining Debt Non-Dischargeable
September 30, 1994	Judgment
January 12, 1995	Memorandum Opinion[4]
January 12, 1995	Order on Motion for Reconsideration

On cross-appeals to the Bankruptcy Appellate Panel (BAP), Judge Steiner's analysis was vacated, but the same end result was reached:

February 13, 1996	Memorandum[5]
February 13, 1996	Judgment
March 29, 1996	Order Denying Reconsideration

---

4 *In Re Demarest*, 176 B. R. 917 (W. D. Wash., 1995)

5 Not published.

On appeal to the Ninth Circuit, the result was affirmed:

September 22, 1997	Memorandum[6]
December 23, 1997	Order

This Petition ensued and raises important federal questions on the topic of bankruptcy fraud. Specifically, the element of reliance and the phrase "obtained by."

---

6 Not published.

Basis for Jurisdiction

This court has jurisdiction over this Petition:

(a) the decision appealed from was decided September 22, 1997.

(b) a timely motion for reconsideration was decided on December 23, 1997.

(c) the statutory basis for these appeals is 28 U.S.C. §§ 1291 and 158.

The Petition should be granted. At some point this case should be decided on the merits.

Applicable Statutes

The single statute applicable to this action, in relevant part, reads as follows:

(a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt --

. . .

(2) for money, property, services, or an extension, renewal or refinancing of credit, to the extent obtained by --

(A) false pretenses, a false representation, or actual fraud, . . .

28 U.S.C. § 523 (a) (2) (A) (1995).

Statement of the Case

This case illustrates the axiom of bad facts making bad law. The Appellants, Debbie and Steve Demarest, sold their home in a transaction that was perfectly normal except for two things. One, the title company was negligent in its independent search of the public record and did not list the mortgage to be paid off from the sellers proceeds at closing. Two, the sellers accepted the excess proceeds thinking they would pay the loan off from other resources.

In fact, they did pay the loan over the next 20 months at which time the title company acquired the loan, demanded immediate payment in full, and sued the Demarests in Superior Court alleging only breach of contract and breach of deed warranty. The Demarests could not then pay the loan in full as their financial condition has severely deteriorated on multiple fronts.

The title company would have prevailed, but for the Demarests filing a Chapter 7 Petition in Bankruptcy seeking an orderly liquidation of their assets.

Faced with the discharge of the Demarests personal liability arising out of "contract", the title company filed an adversary proceeding and relabeled the cause as arising out of "fraud." Problem being, no one had relied on the Demarests - an issue irrelevant to a breach of contract claim, but pivotal to a fraud claim.

Pointedly, the sellers did disclose the existence of this encumbrance three times over: first, in the Listing Agreement; next, in the Purchase and Sale Agreement; and, finally, in calling the escrow agent after the closing, but before depositing the proceeds check.[7]

Nobody paid any attention to what the Demarests wrote or said. Least of all the title company. So, the Demarests deposited the check, a clear breach of their contractual obligations, but just as clearly not a fraud upon anybody.

---

[7] DN 12 (Declaration of Debtor), paragraphs 4, 6 and 14. In fact, the solitary allegation of nondisclosure in the Complaint was ordered stricken. DN 32 (Order Determining Debt Non dischargeable). Imagine that! Fraud based on full disclosure!

Had the Demarests not filed bankruptcy, they would be subject to a civil judgment for breach of contract and/or deed warranty. But because they sought the protection allowed by Congress, they end up subjected to a civil judgment for fraud. How is it that a law designed to protect debtors can be construed such that it penalized the Demarests to the point where they would have been better off not filing for bankruptcy?[8]

The published decision of the Bankruptcy Court holds there is a direct duty owing to the title company.[9] The *un*published decisions of the BAP and the Ninth Circuit reversed the finding of a duty owing to a title company.[10] The Demarests did not owe a duty to the title company.

---

8 The stigma associated with committing fraud is much worse then the stigma of breaching a contract. For example loan applications and job applications ask specifically about judgments based on fraud.

9 "That did not discharge his duty to disclose the error to the title company." and "the proof establishes a direct fraud on Rainier . . ." Memorandum Opinion (Steiner), page 11-12.

10 "Here, Debtors had no duty to disclose . . . to Rainier, because no special relationship existed between Rainier and the Debtors."

Instead, the BAP and the Ninth Circuit predicated liability on a duty owing to the buyers and held that reliance was either not necessary to prove, was subject to some lesser standard of proof, or was proven by the reasonable person standard.

The basis for federal jurisdiction in the court of first instance is 28 USC § 1291 and 158 as this case arises out of a Bankruptcy proceeding.

Argument

Introduction

In a case of result orientated reasoning, hidden behind an unpublished decision, the Ninth Circuit held the sellers of a property liable to a buyer who is not a party to the action and to their title company which did not base a claim on subrogation, where there was no duty owing beyond the disclosures made, where the title company's mistake was independent of what the sellers said or did not say . . . In short, where a dischargeable breach of contract action is recast as a non dischargeable fraud action to keep the debtors from gaining the protection offered by the Bankruptcy Code.

Rather then reargue each of the required elements of fraud, this Petition focuses on the central issue of reliance and accepts the current posture of the case in that the question is whether the buyers[11] relied.

---

[11] Judge Steiner specifically avoided the issue of the buyer's reliance saying: "The Court need not address the debtor's arguments concerning the subrogation of Rainier to claims of the buyer . . ." Memorandum Opinion (Steiner) page 12. Note, the buyers are not parties to the action. The Adversary Complaint does not set forth any allegation of reliance by the buyers. In the

Thus, in order to find fraud as against the buyers, the element of reliance must be eliminated or established by legal fiat. The BAP and the Ninth Circuit did both. And did so in conflict with this Court's precedent.

Reliance Not an Element?

There can be no argument but that reliance has, until now, always been a required element of fraud. In *Field*, which was decided after Judge Steiner first held the Demarests liable, the Court determined what level of reliance was necessary.

That case endorsed and applied the *Restatement of the Law (second) Torts* to bankruptcy fraud which includes reliance as a required element. Justice David Souter, writing for the majority in *Field*, said:

> "No one, of course, doubts that some degree of reliance is required to satisfy the element of causation inherent in in the phrase 'obtained by' . . ."

---

summary judgment proceedings there was no testimony by, or even about, the buyers relying. As a matter of the factual record in this case, the buyers did not rely.

No one, that is, except the BAP as affirmed by the Ninth Circuit. In the decision of the BAP, at page 13, the court reasoned:

> [R]eliance is established when a defendant withholds a material fact in the face of a duty to disclose, . . .

This reasoning is without citation to any law. In the case of *In Re Apte*, 180 B.R. 223 (N.D. Calif. 1995), the court cited *Demarest* for the proposition that:

> "[T]he mere withholding of a material fact in the face of a duty to disclose establishes the requisite causation."[12]

---

12 *Id.* at 229. Judge Russell participated in both BAP panels.

This novel rule of law is fatally flawed in that it merges the previously distinct elements of duty and reliance. It vitiates the role of reliance which is to establish the "requisite causal connection between a Defendants misrepresentation and a Plaintiffs injury." *Basic Inc. v. Levinson*, 485 U.S. 224, 243, 108 S. Ct. 978, 989, 99 l. Ed. 2D 194 (1988).

Imagine a defendant withholding a material fact in a case where the creditor admits that he did not rely on the defendant. Would this be fraud? Not under the *Restatement*. Not under *Field*. But it would be under the analysis of the BAP where reliance is established absolutely when the defendant withholds a material fact in the face of a duty to disclose. The testimony of the creditor is rendered irrelevant. Reliance is rendered irrelevant.

The correct legal standard applicable in cases of nondisclosure should be:

> [R]eliance is ~~established~~ presumed when a defendant withholds a material fact in the face of a duty to disclose, . . .

This would take into account the difficulty of proving reliance in cases of non disclosure[13] while still giving the defendant the opportunity to show that either the creditor in fact did not rely or that any reliance was legally not justified.

A presumption can be rebutted. To hold otherwise would convert fraud to a case of strict liability. Unless this Court is willing to have fraud recast as a tort of strict liability, thereby undermining *Field*, the *Restatement* and common law, it must accept review of this case and ultimately remand for a trial to allow evidence rebutting the presumption that the buyers relied upon the debtors.

Less Reliance Required for Non Disclosure

The Courts below, if not entirely eliminating reliance as an element, certainly lessen its importance to the point of making it inconsequential. Note however, the Restatement's treatment of liability based on nondisclosure reiterates that it is no greater than, or less than, liability based on

---

13 It also fits with the line of cases which take into account the 'special relationship' between some creditors and debtors such as securities and fiduciaries.

affirmative acts of misrepresentation:

> § 551 - Liability for Nondisclosure[14]:
> (1) One who fails to disclose to another a fact that he knows may justifiably induce the other to act or refrain from acting in a business transaction is subject to the same liability to the other as though he had represented the nonexistence of the matter that he has failed to disclose, if, but only if, he is under a duty to the other to exercise reasonable care to disclose the matter in question.
> (2) . . .

In certain special relationships it is permissible to presume reliance or to make it easier to prove reliance in fact. But that does not make it permissible to lessen the level of reliance required. It is one thing to make reliance easier to prove. It is an altogether different thing to lower the level of reliance required to support a fraud claim. The Ninth Circuit does not understand this distinction.

---

14 *Restatement of the Law (Second) Torts* § 551 - Liability for Nondisclosure. (Emphasis added)

Imagine a case where the mortgage lender testified that he did rely on the property owner to disclose the material fact of an existing encumbrance. In the leading 9th Circuit case on this point[15], the debtor did not disclose the existence of a loan against the title. The lender in-fact relied on the debtor and made the loan. In the adversary proceeding that followed, the court held the lender was unjustified in relying on the owner to disclose encumbrances against title. And the debtor was discharged.

Why, in this case, is the creditor held to a lower level of reliance? Is the conduct of a debtor who tells the truth then accepts an overpayment somehow worse then the debtor who continuously lies about the title status?

According to the rule of *Kirsh*, if the Demarests had represented the title was not encumbered (in other words, lied) then the creditor would have had to prove the reliance was justified. But because the Demarests did not lie, the creditor need not prove even that the reliance was justified. This flies in the face of the common sense observed by Justice

---

15 *In re Kirsh*, 973 F. 2d 1454 (9th Cir. 1992). Both counsel cite *Kirsh* as the leading authority on the element of reliance.

Ginsburg:

> QUESTION: . . . Suppose the debtor here had simply transferred the property without sayig on word to the creditor. . . Would the debt then be dischargeable? There would be no representation at all, just a violation of the agreement the debtor sells the property. . . . Dischargeable, right?
> Mr. SEUFERT: . . . I would agree with you, it would be dischargeable.

Field, at 238.

To the extent this is an unsettled question of law, this court should grant the petition and decide whether the requisite level of reliance differs in a case of non disclosure and a case of fraud. And if it does, whether the level of reliance should be scaled in relation to the conduct of the debtor.

Objective or Subjective Standard

Field settled the question whether the proper standard for reliance is the objective reasonable person test or the more subjective standard taking into account the factors of the transaction. Justice Souter wrote clearly:

> "[W]e hold that Section(s) 523 (a) (2) (A) requires justifiable, but not reasonable, reliance."[16]

Despite that unambiguous clarification of the law, in this case, the Ninth Circuit adopted the Apte analysis using the reasonable person test:

> "[T]he reliance element is satisfied by objective proof, i.e., whether a reasonable person might have considered the facts important to his or her decision."

Memorandum, page 2. Despite having the case of *Field* in the briefs, the Ninth Circuit chose to ignore it.

---

16 *Field* at BCD 236. With citation to *Kirsh*.

Obtained By

Justice Ginsburg wrote a concurring opinion in *Field* to highlight an open question on the meaning and effect of the phrase "obtained by." This was briefed below, but was not addressed in the written decisions.

As noted by Justices Souter and Ginsburg, the phrase "obtained by" goes to the issue of causation. Causation, in fraud, depends in large part on reliance. If the creditor does not rely, then the otherwise fraudulent conduct did not cause the harm. As in this case, the harm was caused by the title company's independent mistake. See, *In Re Rieder*, 178 B.R. 373, 380 (S.D.N.Y. 1995):

> "Third, the plaintiffs theory contravenes the unambiguous language in 523 (a) (2) (A) and the inherent sequential order of fraud. The subsection excepts from discharge (1) a debt (2) for services (3) obtained by fraud. Thus the misrepresentation must come first, the reliance second and the damage last."

Fraud can not occur after-the-fact. The Demarests may have *retained* the excess proceeds wrongfully, but they did not *obtain* them wrongfully.[17]

As between the sellers and the buyers, the money at issue was properly owing to the sellers. It was not fraudulent for the Demarests to receive the purchase price from the buyers. The only thing obtained from the buyers was the purchase price, and that was due and owing.

Conclusion

The Petition needs to be granted. The Ninth Circuit has broken from established case law on the issue of reliance and is wrongly making new law in cases of nondisclosure. The rights of these debtors as well as the rights of bankruptcy litigants everywhere are at stake.

DATED: June 13, 1998

Stephen H. Demarest
Appellant, Pro Se

Deborah A. Demarest
Appellant, Pro Se

Appendix

A. September 30, 1994	Order Determining Debt Non-Dischargeable
B. September 30, 1994	Judgment
C. January 12, 1995	Memorandum Opinion
D. January 12, 1995	Order on Motion for Reconsideration
E. February 13, 1996	Memorandum
F. September 22, 1997	Memorandum
G. December 23, 1997	Order

APPENDIX A - ORDER DETERMINING DEBT NONDISCHARGEABLE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON

ADVERSARY NO. A94-04841

RAINIER TITLE COMPANY, INC
V.
DEBORAH AND STEPHEN DEMAREST

JUDGE STEINER

This matter came before the Court September 14, 1994, on defendants' motion for Summary Judgment. Defendants appeared pro se through Stephen H. Demarest, an attorney licensed to practice in Washington, and plaintiff appeared through counsel, Timothy N. Lang of Gordon, Thomas Honeywell, Malanca, Peterson and Daheim. The court heard oral argument and considered the following pleadings; Defendants' Motion for Summary Judgment; Declaration of Stephen Demarest; Declaration of Deborah Demarest; Motion to Amend Complaint; Declaration of Timothy Lang in Support of Motion to Amend; Memorandum in Support of Motion to Amend; Defendants' Supplemental Memorandum Re: Larceny,

Embezzlement, and Willful and Malicious Tort; Memorandum in Opposition to Defendants' Summary Judgment Motion; Declaration of Timothy N. Lang in Opposition to Defendants' Summary Judgment Motion; and the records and files herein.

The Court found that there is no genuine issue of material fact, that the subject debt is non-dischargeable as a matter of law under 11 U. S. C. 523 (a) (2) (A) and 523 (a) (6), and that, therefore, the Court should sua sponte grant summary judgment in favor of the nonmoving party, Rainier Title Company, Inc. See, Cool Fuel, Inc v Connett, 685 F.2d 309, 311 (9th Cir. 1982).

IT IS THEREFORE ORDERED and determined that the $66,609.37 debt owed by defendants Stephen H. Demarest and Deborah A. Demarest to plaintiff Rainier Title Company, Inc. is nondischargeable; it is further

ORDERED that plaintiff Rainier Title Company, Inc. Have and recover judgment against defendants Stephen H. Demarest and Deborah A. Demarest in the sum of $66,609.37, plus costs and prejudgment interest from December 1, 1993 (When Rainier purchased the unsatisfied mortgage and deed of trust), through September 30, 1994; it is further

ORDERED, based on a stipulation of the parties, that the last sentence of paragraph 2.2 of plaintiff's Complaint - i.e., "Defendants did not disclose the Citizens deed of trust to the Boyces" - be stricken from the Complaint.

Dated this __ Day of October, 1994

/s/ The Honorable Samuel J. Steiner

APPENDIX B - JUDGMENT AGAINST DEBORAH A. DEMAREST AND STEPHEN H. DEMAREST

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON

RAINIER TITLE COMPANY, INC
V.
DEBORAH AND STEPHEN DEMAREST

JUDGMENT SUMMARY

1. Judgment Creditor: Rainier Title Company, Inc.
2. Judgment Debtors: Deborah A. Demarest and Stephen H. Demarest
3. Principal Amount: $66,609.37
4. Costs: $120.00
5. Prejudgment Int. $3,147.29
TOTAL $69,876.66
6. Principal judgment shall bear interest at 5.67% per annum
7. Attorney for Judgment Creditor: Timothy Lang

Dated this __ Day of October, 1994

/s/ The Honorable Samuel J. Steiner

APPENDIX C - MEMORANDUM OPINION

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON

ADVERSARY NO. A94-04841

RAINIER TITLE COMPANY, INC
V.
DEBORAH AND STEPHEN DEMAREST

MEMORANDUM OPINION

This matter is before the court on defendants' motion for reconsideration of the Court's order granting summary judgment of nondischargeability in favor of the plaintiff.

I. Facts

In September, 1991, the debtors entered into a purchase and sale agreement for the sale of their Tacoma home to Charlaine and Richard Boyce. The agreement required the debtors to convey clear title to the property. The title was encumbered by a deed of trust in favor of Meridian Mortgage, successor to Citizens' Federal Savings and Loan Association. According to the debtors, they disclosed the Meridian deed of trust on the purchase and sale

agreement. However, Rainier Title Company, which provided title insurance, overlooked Meridian's interest when researching the title. As a result, Meridian was not paid out of closing.

Debtor Stephen Demarest, an attorney, became aware of the error when he reviewed the closing documents. According to his August 9, 1994, declaration, he assumed the escrow agent had made a mistake. Mr. And Mrs. Demarest both signed the closing documents, including a statutory warranty deed. Mr. Demarest did not mention the error, thinking the escrow agent might discover it before issuing checks. Later, Mrs. Demarest picked up the check for the proceeds and took it to here husband's office. She realized that the check was approximately $65,000 too high, and she remarked to her husband that the amount must be wrong. Mr, Demarest called the escrow agent in here presence and left a message requesting verification of the amount. The agent returned the call and confirmed the amount was correct. According to his declaration, Mr. Demarest then assumed either that Meridian's deed of trust had been improperly recorded or that Rainier Title has overlooked it when searching the record. Mrs. Demarest, a flight attendant, had to leave

town, but she was aware that the error still had not been clarified. She endorsed the check, leaving it to her husband to handle the matter.

At the time of this transaction, the debtors were in the process of buying a bed and breakfast in Friday Harbor, Washington, and selling another property known as Yacht Club Estates. Mr. Demarest stated in his declaration that the debtors hoped to receive the downpayment from the Yacht Club Estates sale prior to its closing so they could use it to fund the downpayment for the bed and breakfast. However, they were not certain that they would receive the funds in time. They retained the $65,000 that should have gone to Meridian and used it initially for the downpayment on the bed and breakfast. Later they put it back into their account as part of a loan from their seller and thereafter used it in their other business ventures.

The debtors continued making monthly payments to Meridian pursuant to the note, but did not maintain homeowner's insurance. Not until Meridian discovered the lack of insurance did the debtors disclose that they had sold the house. Meridian then obtained a lender's policy and began allocating a portion of the monthly payments to the insurance premiums. The

debtors balked at this and stopped making monthly payments in July, 1993. Meridian commenced foreclosure proceedings. Rainier then paid Meridian, took an assignment of the deed of trust, and sued the debtors in state court.

II. Procedure / Issues

The debtors filed their chapter 7 petition on February 16, 1994, and Rainier filed this adversary proceeding alleging that the debt is nondischargeable pursuant to 11 U. S. C. § 523 (a) (2). The debtors filed a motion for summary judgment on August 15, 1994, and Rainier followed with a motion to amend its complaint to add claims under § 523 (a) (4) and (6). The debtors opposed the amendment and responded on the merits of the new claims. The Court implicitly allowed the amendment,found the debt nondischargeable as a matter of law under §§ 523 (a) (2) and 523 (a) (6), and sua sponte granted summary judgment in favor of Rainier Title Company.

Next, the debtors moved for reconsideration, urging the Court to vacate its summary judgment on both claims. As to the § 523 (a) (2) claim, the Court's *sua sponte* entry of summary judgment to the nonmoving party was

procedurally proper, since there was no genuine issue of material fact and the uncontroverted facts support such a ruling. Portsmouth Square, Inc. v. Shareholders' Protective Committee, 770 F.2d 866, 869 (9th Cir. 1985). However, the debtors also contend that the Court improperly granted summary judgment under § 523 (a) (6), both on the merits and because there was no motion before the Court. Finally, the debtors assert that Mrs. Demarest's separate liability to Rainier should be discharged, and they present additional facts in support of that contention. The issues are thus whether the undisputed facts support summary judgment under §§ 523 (a) (2) and (6) as to Mr. Demarest and hence the community, and further whether the debtors have raised a genuine issue of material fact concerning the separate liability of Mrs. Demarest.

In order to prevail on their motion for reconsideration, the debtors must show "manifest error in the prior ruling or . . . new facts or legal authority which could not have been brought to [the Court's] attention earlier with reasonable diligence." CR 7 (3) (1), Local Rules W. D. Wash.; LBR 9013.

III. Discussion

A. Liability of Mr. Demarest and the Community under § 523 (a) (2). Section 523 (a) (2) (A) of the Bankruptcy Code provides for the nondischargability of any debt to the extent incurred by "false pretenses, a false representation, or actual fraud . . . ." To establish fraud, the plaintiff must show that it was damaged by the defendant's knowing misrepresentation of material fact, made with the intention to deceive, and on which plaintiff relied. In Re Kirsh, 973 F.2d 1454 (9th Cir. 1992).

Section 523 (a) (2) (A) includes both false representation, which is an express misrepresentation, and false pretense, which involves "an implied misrepresentation or conduct intended to create and foster a false impression." Matter of Weinstein, 31 B. R. 804, 809 (Bankr. E.D.N.Y. 1983). It is well settled that silence can create a false impression, providing the basis for a misrepresentation that is actionable under § 523 (a) (2) (A). In Re Howarter, 114 B. R. 682, 684-685 n. 2 (Bankr. 9th Cir. 1990); Haddad v. Haddad (In Re Haddad), 21 B. R. 421, 423-23 (Bankr. 9th Cir. 1983).

The debtors do not suggest that fraud cannot be inferred from silence or that the existence of the Meridian deed of trust was not material. Instead, they contend that the elements of intent and reliance are lacking. They maintain further that the title company is not subrogated to a nondischargeability claim which may have been held by the buyer or the mortgagee.

1. Intent. Mr. Demarest states that he lacked fraudulent intent, because he intended to pay back the money when he received funds from the Yacht Club Estates closing, which he estimated to be within forty-five days. When that sale failed to close, the debtors made monthly payments for a period of time, which they contend illustrates their good intentions. The issue, however, is not whether the debtors intended to pay back the money. The tacit representation to Rainier was that all encumbrances were being satisfied out of closing, and that the debtors were delivering clear title to property. Based on this representation, the debtors acquired approximately $65,000 which they would not have otherwise obtained. The situation is analogous to one in which a debtor has obtained an extension of credit by false pretenses. The intent issue thus revolves around the

procurement of the funds, not the intent to repay or not to repay.

Mr. Demarest clearly knew that if the Rainier/Meridian encumbrance was not discovered, he and his wife would receive that money from closing. Had he not intended this result, he would have disclosed the error. Further, Mr. Demarest knew that the mistake was either Meridian's or Rainier's and that one or the other would bear any loss that may ultimately ensue. Accordingly, the Court concludes that these facts demonstrate an intent to deceive not only Meridian but Rainier as well.

2. Reliance. The debtors contend further that Rainier did not rely or did not reasonably rely on their silence regarding title. The argument is based primarily on In re Kisich, 28 B. R. 401 (9th Cir. Bankr. 1983). In Kisich, the debtor wife sold her home, which was encumbered by a 16-year-old IRS lien. The title report did not reveal the lien. According to the debtor's uncontroverted declaration, she informed the title company of the lien. She then assumed it had lapsed, because the title company assured her that there was no IRS lien of record. Two years after closing, the IRS threatened to foreclose, and the title company satisfied the

lien. The debtors sought a declaratory ruling from the bankruptcy court that the title company held no valid nonvoidable liens against the property.

The title company claimed that the debt was nondischargeable under § 523 (a) (2), on the basis of Mrs. Kisich's alleged omission of - material facts. On this issue, the Court held that the debtor lacked the requisite intent to deceive, in that the title company had not refuted the debtor's declaration that she had in fact disclosed the existence of the tax lien. This finding would alone have been sufficient to support a ruling in favor of the debtors. However, the Court found in addition that the element of reliance had not been satisfied.

At the time Kisich was decided, the courts were employing a reasonableness standard for reliance. That is, not only must the creditor have in fact relied, its reliance must have been reasonable under the circumstances. Applying this standard, the Kisich Court concluded that the buyer did not in fact rely on the debtor's representations regarding title, since it relied solely the conclusions of the title company. As to the title company, the Court announced what amounts to a per se rule that title companies can never satisfy the reliance requirement of §

523 (a) (2) (A):

> [I]t is patently unreasonable for the appellant [title company] to have relied on the debtors' representations since the very essence of a title insurer's function is to ascertain the state of the title to property . . .
>
> The appellant has been compensated by the (buyers] for undertaking such a risk. Section 523 (a) (2) was never intended to be used by errant insurers to shift the risk of loss to the debtor.

Id. at 403-404.

This Court concludes that Kisich does not control the results of this case. First, the uncontroverted evidence was that Mrs. Kisich did not remain silent when presented with the title company's mistake. There having been no misrepresentation, the Court did not have to reach the issue of reliance, and its sweeping statements in that regard are therefor dicta. Further, this Court agrees with the dissent, which stated, "The majority's view that § 523 (a) (2) was never intended to be used by errant insurers to shift the risk of loss to the debtor is unsupported by authority or reason." Id. at

405. Not only is the majority's conclusion unsupported, it is contrary to Ninth Circuit authority and the conclusions of other courts as well.

In In re Kirsh, the Ninth Circuit addressed the standard of reliance required under § 523 (a) (2) (A). In so doing, the Court established two principles: first, that § 523 (a) (2) (A) encompasses the common law elements of fraud, and second, that in false representation cases, the plaintiff must show that reliance was justifiable. In adopting the common law standard of justifiable reliance, the Court resolved for this Circuit a split of authority. See, e.g. In re Ophaug, 827 F.2d 340 (8th Cir. 1987) (requiring actual reliance only); and In re Mullet, 817 F.2d 677 (10th Cir. 1987) (requiring that reliance be reasonable). Prior to Kirsh, the Ninth Circuit had, without analysis, required a showing of reasonableness. In re Rubin, 875 F.2d 755 (9th Cir. 1989). To determine the content of the common law, the Kirsh Court cited both Prosser and Keeton on the Law of Torts and Restatement (Second) of Torts. According to Prosser and Keeton, the reason that reliance must be justifiable is to "[p]rovide some objective corroboration to plaintif ' s claim that he did rely (citation omitted.)" In re Kirsh, supra, at 1458. Reliance,

on the other hand, establishes the causal relation between the defendant's action and the plaintiff's injury. Basic Inc. v. Levinson, 485 U.S. 224, 108 S.Ct. 978, 992 L.Ed.2d 194 (1988).

In In re Harris, 458 F.Supp. 238 (D.Or. 1976), aff'd Matter of Harris, 587 F.2d 451 (9th Cir. 1978), a case decided under the Bankruptcy Act, the Court recognized that the standard of reliance for nondisclosure necessarily differs from the standard applicable to affirmative misrepresentation. In instances of nondisclosure, it is impossible to demonstrate reliance, since to do so requires proof of a speculative state of facts, i.e. how on would have behaved if omitted material information had been disclosed. Relying on Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-154, 92 S.Ct. 1456, 31 L.Ed. 21 741 (1972), a securities fraud case from the Supreme Court, the Oregon Court concluded that the common law does not require positive proof of reliance in concealment cases.

> All-that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. This obligation to disclose and this withholding of a

> material fact establish the requisite element of causation in fact.

458 F.Supp. at 242, quoting from 406 U.S. at 153-54. Accord, Basic Inc. v. Levinson, supra (1988). In a brief opinion affirming the District Court in Harris, the Ninth Circuit adopted both the reasoning and the conclusions of the lower court. Hence this Court concludes that Harris, not Kisich, reflects the Ninth Circuit standard on the issue of reliance in cases of fraudulent concealment.

As noted by the plaintiff, in In re Homer, 168 B.R. 790, a Georgia Bankruptcy Court rejected the broad statement of the Kisich panel "to the extent it might be read to imply that lenders and title insurers are always charged with knowledge of the public record." Id. at 803. The Georgia Court's conclusion is based in part on the Ninth Circuit's language in In Re Kirsh as follows:

> A plaintiff must show that "he was justified in his reliance," but negligence in failing to discover an intentional misrepresentation is no defense . . . Moreover, "[t]he fact that an investigation would have revealed the falsity of the misrepresentation will not

> alone bar his recovery, and it is well established that he is not held to constructive notice of a public record which would reveal the true facts." Eugene Parks Law Corp. Defined Benefit Pension Plan v. Kirsh (In re Kirsh), 973 F.2d 1454, 1459 (9th Cir. 1992), quoting Justice Roger Traynor in Seeger v. Odell, 18 Cal.2d 409 414-15, 115 P.2d 977 (1941).

Id. at 803.

In short, where an individual knows, as did these debtors, that another is acting without knowledge of material facts, the reliance element is satisfied by objective proof, i.e. whether a reasonable person might have considered the facts important to his or her decision. Conversely, it is not a defense that the plaintiff's lack of knowledge was based on his own negligence in ascertaining the truth. In this case, the debtor husband, an attorney, experienced in real estate matters, knew that the title company was undertaking to ensure a defective title, and further that it was relying on incorrect information. Yet he did nothing to dispel the false impression under which the title company was operating, and he even signed a warranty deed. He may have disclosed

the encumbrance on the purchase and sale agreement. However, that did not discharge his duty to disclose the error to the title company. He also asked one limited question of the escrow agent, thereby confirming for himself that the error was not a mathematical one but rather "that either the deed of trust was improperly recorded (and not in the chain of title), or that the title company had been negligent in searching the record." Declaration of Stephen Demarest. This phone call did not discharge the debtors' duty to disclose the error to the title company. To the extent that Kisich permits a different result, it should be confined to its facts.

The Court need not address the debtor's arguments concerning the subrogation of Rainier to claims of the buyer or Meridian, since the proof establishes a direct fraud on Rainier through the use of false pretenses. Matter of Weinstein, supra, cited with approval in In re Howarter, 114 B.R. at 685, n.2.

B. Separate Liability of Mrs. Demarest Under S 523 (a) (2) (A). The Ninth Circuit addressed the issue of spousal liability for a false financial statement in In re Lansford, 822 F.2d 902 (9th Cir, 1987) There the Court concluded that Cecily Lansford was culpable by virtue of her own involvement in the transaction, notwithstanding that it was her husband who actually prepared the statement. Her involvement included the following:

> [B]oth defendants had a hand in initiating discussions with La Trattoria, even if through John Lansford. . . . Cecily Lansford was the one who discovered the possible restaurant venture, and . . . she was a signatory on the financing arrangement of the real estate project that went into default the status of which was misrepresented to La Trattoria. Finally, she signed the purchase documents transferring the restaurant from La Trattoria to the Lansfords, which documents repeat one of
> the more egregious misrepresentations contained in the financial statement.

Id. at 905.

While the Court found this evidence "far from overwhelming," it was sufficient to uphold the trial court's ruling that both defendants were responsible for the false financial statement.

The Court expressed relief that it was able to avoid the issue whether the husband's fraud could be imputed to the wife under agency principles. In re Cecchini, 780 F.2d 1440 (9th Cir. 1986), holds that a business partner's wrongful conduct can be imputed to a debtor for purposes of § 523 (a) (6) when the partner was acting in the ordinary course of business and the debtor shared in the benefits of the wrongful conduct. In Lansford, the Court implied that Cecchini might be overly broad in light of the Bankruptcy Code's purpose of providing a fresh start, stating that "the breadth of the proposition stated in Cecchini deserves more thorough consideration before its application to the circumstances presented in this case." In re Lansford, supra at 905.

The Court concludes that the facts as described in Mrs. Demarest's declaration establish separate culpability on her part. The undisputed facts are that Mrs. Demarest signed the closing documents, including the statutory warranty deed, and that she knew of the existence of the Meridian deed of trust. She

noticed the mistake when she saw the check. She was present when her husband called the escrow company and when the agent returned his call, verifying that there had been no error on its part. Being aware of the mistake, Mrs. Demarest had an independent duty to disclose it or ensure that her husband did. Instead, she endorsed the check and allowed the funds to be used as a downpayment for the bed and breakfast which was placed in her name. In short, Mrs. Demarest participated in the concealment which resulted in a direct benefit to her.

C. Liability Under § 523 (a) (6). After allowing the plaintiff to amend its complaint to add a cause of action under § 523 (a) (6), the Court granted summary judgment on that bases. The defendants have moved for reconsideration, contending that the matter was not before the Court, and that the ruling lacked substantive merit. The Court agrees with the debtors' position, namely that the plaintiff has not stated a proper legal basis for a claim under § 523 (a) (6).

The plaintiff's theory is that the debtors held the $ 65,000 in constructive trust and thereafter converted the funds. This approach misconstrues the nature of constructive trust.

In In re Tleel, 876 F.2d 769 (9th Cir. 1989), the Court noted that constructive trust is not actually an interest in property but rather an equitable remedy, which is inchoate until impressed by a court on specific property. The remedy is appropriate where one is under an equitable duty to convey property to another on the ground that he would be unjustly enriched if he were permitted to retain it. Baker v. Leonard, 120 Wn.2d 538, 548 (1993). If the money which the debtors obtained, that is the $65,000, still existed, the circumstances would surely justify the imposition of a constructive trust. However, the funds do not exist, and they were never impressed with a trust. Accordingly, the plaintiff's theory fails, and the motion for reconsideration on this issue should be granted.

IV. Conclusion

A. The defendants/debtors' motion for reconsideration of the Court's Order granting the plaintiff judgment pursuant to § 523 (a) (2) of the Bankruptcy Code should be denied.

B. The defendants/debtors' motion for reconsideration of the Court's order granting summary judgment to the plaintiff pursuant to § 523 (a) (6) of the Bankruptcy Code should be granted.

DATED at Seattle, Washington, this 12 day of January, 1995.

/S/ SAMUEL J. STEINER
UNITED STATES BANKRUPTCY JUDGE

APPENDIX D - ORDER ON MOTION FOR RECONSIDERATION

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON

ADVERSARY NO. A94-04841

RAINIER TITLE COMPANY, INC
V.
DEBORAH AND STEPHEN DEMAREST

JUDGE STEINER

This matter having come before the Court on the defendants/ debtors' motion for reconsideration of the Court's Order of September 30, 1994; the defendants being represented by Kary L. Krimer, and the plaintiff appearing through Timothy N. Lang of counsel; and the Court having heretofore entered its written Memorandum Opinion; now therefore, it is ORDERED as follows:

1. The defendants/debtors' motion for reconsideration of the Court's Order granting the plaintiff judgment pursuant to § 523 (a) (2) of the Bankruptcy Code is denied.

2. The defendants/debtors' motion for reconsideration of the Court's Order granting summary judgment to the plaintiff pursuant to § 523 (a) (6) of the Bankruptcy code is granted.

DATED at Seattle, Washington, this 12th day of January, 1995.

/S/ SAMUEL J. STEINER
UNITED STATES BANKRUPTCY JUDGE

APPENDIX E - MEMORANDUM (not for publication)

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

DEMAREST
V.
RAINIER TITLE

BEFORE RYAN,[18] RUSSELL, AND HAGAN,
BANKRUPTCY JUDGES

Rainier Title Company ("Rainier") brought an adversary proceeding to except debt from discharge based on §§ 523 (a) (2) (A) and (a) (6) of the Bankruptcy Code (the "Code").[19] Chapter 7 debtors, Stephen and Deborah Demarest ("Debtors"), moved for summary judgment. The bankruptcy court sua sponte granted summary judgment in favor of Rainier under §§ 523 (a) (2) and (a) (6). Debtors moved for reconsideration. The bankruptcy court denied Debtors' motion as to § 523 (a) (2), but granted it as to the § 523 (a) (6) claim.

---

18 Hon. John E. Ryan, Bankruptcy Judge for the Central District of California, sitting by designation.

19 The Code is set forth in 11 U.S.C. §§ 101-1330 (1995).

Debtors appeal and Rainier cross appeals. we AFFIRM in part and REVERSE in part the bankruptcy court's order.

FACTS

In 1986, Stephen Demarest purchased a home in Tacoma, Washington (the "Property"). To help finance the purchase, Stephen assumed an existing loan on the Property held by Meridian Mortgage ("Meridian"). Later, Stephen and Deborah were married.

In September, 1991, Debtors entered into a purchase and sale agreement for the sale of the Property to Charlaine and Richard Boyce ("Buyers"). As part of the transaction, Debtors also signed an earnest money agreement listing Meridian as mortgagee. In both agreements, Debtors were required to convey clear title to the Property.

Later, Buyers retained Rainier as title insurer. The title agreement provided that Rainier would receive all of Buyers' rights if Rainier settled a claim under the title policy.[20] Rainier

---

20 Paragraph 11 of Buyers' title insurance policy provides:

Whenever the Company shall have settled a claim under this

conducted a title search and failed to uncover Meridian's $65,000 lien.

On November 14, 1991, Debtors met with the escrow agent to sign the closing documents. Upon reviewing the documents, Stephen noticed the omission of Meridian,' s interest. Debtors did not inform anyone of the omission and signed the documents. As a result, Meridian was not paid out of the sale proceeds.

Debtors allege that they signed the documents because they thought the escrow agent would eventually discover the mistake. Later, Debtors received $65,000 more than they should have received. Without disclosing the omission of Meridian's lien, Stephen called the escrow agent to ask if the amount was correct. The agent returned the call and confirmed that the

---

policy all right of subrogation shall vest in the Company unaffected by any act of the insured claimant. The Company shall be subrogated to and be entitled to all rights and remedies which such insured claimant would have had against any person or property in respect to such claim had this policy not been issued and if requested by the Company, such insured claimant shall transfer to the Company all rights and remedies against any person or property necessary in order to perfect such right of subrogation and shall permit the Company to use the name of such insured claimant in any transaction or litigation involving such rights or remedies.

Reetz Decl. 6, Appellee R. at Ex. 21, 6.

amount was correct. Stephen concluded that if the escrow company had not miscalculated the amount, either Meridian's lien had not been properly recorded or Rainier had made a mistake.

At the time of the sale, Debtors were in the process of purchasing and renovating property in Friday Harbor, Washington (the "Friday Property"). Debtors expected to close this transaction in early December 1991. Initially, Debtors planned to use the proceeds from the sale of another property for the down payment on the Friday Property. Instead, Debtors used the $65,000 that should have been paid to Meridian.

During the next 20 months, Debtors made monthly mortgage payments to Meridian. However, Debtors failed to renew their homeowner's insurance on the Property. In response, Meridian obtained a lenders liability policy on the Property and added the cost of the policy premium to the loan balance. Debtors objected and stopped making their monthly payments in July, 1993. Thereafter, Meridian initiated foreclosure proceedings. Rainier learned of these proceedings and purchased Meridian's interest for $66,609.37.

On February 16, 1994, Debtors filed for chapter 7 relief under the Code. On June 10, 1994, Rainier initiated an adversary proceeding, alleging that the $65,000 debt to Rainier was nondischargeable under Code § 523 (a) (2) (A) because it was obtained through false pretenses, false representations or actual fraud (the "Complaint"). Rainier later moved to amend the Complaint to include additional claims under Code §§ 523 (a) (4) and (a) (6). Debtors opposed the motion to amend and moved for summary judgment. On September 14, 1994, the bankruptcy court heard argument on the motions. The court allowed the amendment, denied Debtors' request for summary judgment and sua sponte granted summary judgment in favor of Rainier on the §§ 523 (a) (2) (A) and (a) (6) claims.

On October 7, 1994, Debtors filed a motion for reconsideration. In the motion, Debtors argued that summary judgment was improper under § 523 (a) (2) (A) because the elements of reliance and intent were not established. Debtors also contended that the bankruptcy court erred on the merits as to its § 52 3 (a) (6) ruling.

On January 12, 1995, the bankruptcy court denied Debtors' reconsideration motion under § 523 (a) (2) (A) . On the intent issue, the bankruptcy court held that Debtors intended to deceive Rainier by knowingly failing to disclose the omission of Meridian's lien in the escrow instructions. As to reliance, the court held that this element was satisfied because Buyers and Rainier acted without knowledge of material facts that a reasonable person would consider important in the transaction. The bankruptcy court granted Debtors' reconsideration motion on the § 523 (a) (6) cause of action, holding that Rainier had not stated a proper legal basis for a claim under that section.

On January 20, 1995, Debtors filed their notice of appeal, and on January 26, 1995, Rainier filed its notice of cross appeal.

ISSUES PRESENTED

1. Did the bankruptcy court err in holding that Debtors' debt to Rainier was nondischargeable under § 523 (a) (2) (A)?

2. Did the bankruptcy court err in holding that Rainier did not have a nondischargeable claim under § 523 (a) (6)?

STANDARD OF REVIEW

Federal law governs the standard of review for summary judgment. See, Allstate Insurance Company v. Ellison, 757 F.2d 1042, 1044 (9th Cir. 1985). The standard of review of a grant of summary judgment is de novo. Cleary v. News Corp. and HarperCollins Publishers, Inc., 30 F.3d 1255, 1259 (9th Cir. 1994). In reviewing the bankruptcy court's grant of summary judgment, we must determine, viewing the evidence in the light most favorable to the non-moving party, whether there are any genuine issues of material fact and whether the bankruptcy court correctly applied the relevant substantive law. Tzung v. State Farm Fire & Casualty. Co., 873 F.2d 1338, 1339-40 (9th Cir. 1989).

DISCUSSION

I. Section 523 (a) (2) (A)

Section 523 (a) (2) (A) provides that:

> (a) A discharge under section 727 of this title does not discharge an individual debtor from any debt --
>
> . . . .

(2) for money, property, services, or an extension, renewal or refinancing of credit, to the extent obtained by

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

11 U. S. C. § 523 (a) (2) (A) (1995).

To establish a § 523 (a) (2) (A) claim, a creditor must show that: (1) the debtor made the misrepresentations; (2) at the time, he knew the misrepresentations were false; (3) he intended to deceive the creditor; (4) the creditor relied on the misrepresentations; and (5) the creditor sustained loss or damage as a result of the representations. See, Eugene Parks Law Corp. Defined Benefit Pension Plan v. Kirsh (In re Kirsh), 973 F.2d 1454, 1457 (9th Cir. 1992). These elements must be established by a preponderance of the evidence. Grogan v. Garner, 498 U. S. 279, 287 (1991).

Section 523 (a) (2) (A) applies to both express misrepresentation and "implied misrepresentation or conduct intended to create a false impression." Matter of Weinstein, 31 B.R. 804, 809 (Bankr. E.D.N.Y.

1983). Silence can create a false impression that constitutes a misrepresentation actionable under § 523 (a) (2) (A). In re Howarter, 114 B.R. 682, 684-85 n.2 (Bankr. 9th Cir. 1990). Here, Debtors allegedly created a false impression by failing to disclose the omission of Meridian's lien from the escrow instructions.[21]

A. Intent

Debtors concede that they knowingly failed to disclose to Buyers and Rainier that the Property was encumbered by Meridian's lien. Accordingly, the first and second elements of § 523 (a) (2) (A) have been satisfied. The first issue on appeal is whether Debtors intentionally failed to disclose this material information.

Debtors contend that they lacked the requisite intent because they intended to pay Meridian in full. In support, they point out that they made

---

21 Rainier also contends that Debtors made an express misrepresentation when they signed the escrow instructions which stated that all terms and conditions of the original earnest money agreement had been satisfied. The bankruptcy court did not hold whether Rainier had a § 523 (a) (2) (A) cause of action for express misrepresentation and, therefore, we will not address that issue on appeal.

20 monthly payments to Meridian after the Property was sold. The bankruptcy court did not find this fact persuasive, because the issue was not Debtors' intent eventually to repay Meridian, but rather Debtors' intent to deceive Buyers in order to receive the additional $65,000. We agree.

The Ninth Circuit Court of Appeals has held that because a debtor is unlikely to testify directly that his intent is fraudulent, the court may deduce fraudulent intent from all the facts and circumstances of the case. Devers v. Bank of Sheridan, Montana (In re Devers), 759 F.2d 751, 754 (9th Cir. 1985).

Here, it is undisputed that Debtors improperly received the $65,000 because they failed to disclose this information. It is also undisputed that Debtors failed to disclose this information that resulted in their improper receipt of the $65,000. If Debtors had not intended this result, they easily could have disclosed the problem instead of letting the sale close under the false assumption that the Property was free and clear of all liens.

Debtors' assertion that they intended to repay Meridian does not warrant a contrary result. In In re Rodgers, 115 B.R. 678 (Bankr. C.D. Cal.

1990), a creditor brought a § 523 (a) (2) (A) nondischargeability action alleging that debtor committed actual fraud by ordering tools with no intention to pay. The debtor responded that he eventually intended to pay for the tools, although at a substantially later time than agreed. Id. at 683. The court held that the debt was nondischargeable because debtor knowingly entered into an agreement that he could not fulfill. Id. at 684.

Like the creditor in Rodgers, Debtors entered into an agreement to convey clear title to the Property knowing that they could not satisfy this condition without paying off Meridian's lien at the time of closing. Debtors' intent to repay does not excuse their fraudulent intent to allow the sale to close without passing clear title. No material issue of fact exists regarding Debtors' nondisclosure of this key information at the time of sale or Debtors' intent to allow the sale to close without paying Meridian. Accordingly, the intent element is met.

B. Reliance

The next element that Rainier must establish is that it relied on the false impression

created by Debtors' silence.[22] Reliance establishes the causal connection between a debtor's misrepresentation and a plaintiff's injury. See Basic, Inc. v. Levinson, 485 U.S 224, 243 (1988).

In nondisclosure cases, it is impossible to demonstrate that the plaintiff "relied" on the defendant's statement "because to do so would require-proof of a speculative state of facts, i.e. how one would have behaved if the omitted information had been disclosed." In re Apte, 180 B.R. 223, 229 (Bankr. 9th Cir. 1995) (citations omitted). Accordingly, reliance in

---

22 Debtors rely on In re Kisich, 28 B.R. 401 (Bankr. 9th Cir. 1983), to support their contention that Rainier did not rely on Debtors' silence regarding title. In Kisich, we held that it is patently unreasonable for a title insurer to rely on a debtor's representations because a title insurer is retained to examine title. at 403-04. The bankruptcy court held that Kisich was inapplicable for two reasons. First, the debtor in Kisich never made any misrepresentations, and the bankruptcy court viewed our comments as dicta. Second, the bankruptcy court concurred with Judge Elliott's dissent in Kisich where he states: "the majority view that § 523 (a) (2) was never intended to be used by errant insurers to shift the risk of loss to the debtor is unsupported by authority or reason." at 405. The bankruptcy court, instead, chose to rely on In re Harris, 458 F. Supp. 238 (D. Or. 1976), aff'd, Matter of Harris, 587 F.2d 451 (9th Cir. 1978), cert., denied, Harris v. Inahara, 442 U.S. 918 (1979), which recognized that the standard for reliance in the nondisclosure situation necessarily differs from its application when affirmative misrepresentation is present.

the nondisclosure context may be established when a defendant "withholds a material fact in the face of a duty to disclose." Id. (emphasis added).

Here, the bankruptcy court determined that Debtors had a duty to disclose the error to the title company. However, the court did not clearly set forth its rationale for establishing such a duty. In general, a duty to disclose does not exist between parties that are dealing at arm's length.[23] Oates v. Taylor, 199 P.2d 924, 927 (Wash. 1948). However, Washington courts are moving away from the policy of "caveat emptor." Liebergesell v. Evans, 613 P.2d 1170, 1176 (Wash. 1980). Today, Washington courts impose a duty to disclose if a special relationship exists between the parties. Colonial Imports, Inc. v. Carlton Northwest, Inc., 853 P.2d 913, 917 (Wash. 1993). A special relationship exists where the relationship is based on trust and confidence, one party is relying upon the superior specialized knowledge and experience of the other, one party has knowledge of a material fact not easily discoverable by the other, or there

---

23 There is no evidence that the transaction was not at arms length.

exists a statutory duty to disclose. Id.;[24] also Favors v. Matzke, 770 P.2d 686, 690 (Wash. Ct. App.), review denied, 784 P.2d 531 (1989).

---

24 In Colonial Imports, plaintiff, Colonial, and defendant, Carlton, were automobile dealers. Between May and July 1988, Carlton sold a number of vehicles to a wholesale broker in three separate transactions. Colonial Imports, 853 P.2d at 914. In each case, Carlton transferred title to the vehicles to the broker in exchange for a $5,000 deposit. at 915. The remaining balance was due within five days, but the broker was consistently late.

The broker would then sell the vehicles to another dealer. In July 1988, Colonial contracted with the broker to purchase 20 vehicles. Colonial learned that the vehicles were being supplied by Carlton, so it contacted Carlton to inquire whether Carlton had experienced any problems with the broker. Carlton responded that the broker always paid without mentioning the broker's late payment history or the $5,000 deposit condition. Colonial paid the broker, but the broker never paid Carlton. The broker filed bankruptcy and neither party was able to recover from the broker. The question then became who should bear this loss. Colonial brought a negligent misrepresentation action against Carlton, because Carlton did not disclose all of the facts regarding Carlton's relationship with the broker. at 916.

The Washington Supreme Court held for Carlton, finding that Carlton had no duty to disclose to Colonial. at 917. The court found no special relationship between the parties, because the parties had only spoken to each other once, both principals were experienced businessmen, and each party had conducted an independent transaction with the broker.

Here, Debtors had no duty to disclose Meridian's lien to Rainier, because no special relationship existed between Rainier and Debtors. Rainier was paid to perform a title search and disclose all encumbrances against the Property. It is unreasonable to believe that Rainier was relying on the superior, specialized knowledge and experience of Debtors. Further, although Debtors had knowledge of Meridian's lien, this fact was easily discoverable. Finally, Debtors had no statutory duty to disclose the lien. Because Debtors had no duty to disclose to Rainier, we hold that Rainier did not rely upon Debtors' silence regarding title.

The analysis, however, does not end here. Buyers, title insurance policy provides that, because Rainier satisfied Meridian's lien, Rainier is assigned and subrogated to all rights and remedies that Buyers had against Debtors. Accordingly, we should examine whether Debtors had a duty of disclosure to Buyers, because if they did, then Rainier, as subrogee and assignee of Buyers' rights, can establish reliance.[25]

---

25 Although this issue was not raised on appeal, the court can "decide an issue that is not raised on appeal, if that issue is purely legal and is fully supported by the record." Oaks of

As stated by Judge Elliott in dissent in Kisich:

> I submit that the better view is that an assignee, voluntary or by operation of law, has standing to assert a claim for relief for nondischargeability except where Congress has denied that relief to assignees, as Congress has done in the case of alimony and child support.

28 B.R. 401, 405 (Bankr. 9th Cir. 1983) (Elliott, J. , Dissenting).[26]

Woodlake Phase III, Ltd. v. Hall Bayoutree Assoc. Ltd. (In re Hall Bayoutree Assoc. Ltd.) , 939 F.2d 802, 804 (9th Cir. 1991).

26 Although there is no Ninth Circuit authority which states that a § 523 (a) (2) (A) claim is assignable, we have held that

523 (a) (6) claim is assignable because that section:

determines the character of the debt by focusing the analysis on the nature of the act from which the debt arises, not the identity of the claimant. The assignee of a claim takes the claim with all rights attendant, and therefore the nondischargeable character of the debt in the hands of the original claimant is transferable.

Florida v. Ticor Title Insurance Co. of Calif. (In re Florida), 164 B.R. 636, 640 (Bankr. 9th Cir. 1994). We believe this reasoning is directly applicable here.

The Washington Supreme Court has held that a duty to disclose may arise 'if there is a previous agreement between the parties. In Washington Mutual Savings Bank v. Hedreen, 886 P.2d 1121, 1122 (Wash. 1994), defendant Hedreen, a developer, secured a loan from plaintiff bank to finance the retail and office portions of a building. The bank issued a commitment letter to Hedreen providing that at the closing Hedreen was to execute a master lease with R.C. Hedreen Company for all of the building's unleased office space. Hedreen's chief financial officer prepared the master lease but failed to include all of the building's unleased office space as required by the commitment letter. The master lease was reviewed by both the bank's attorney and a bank employee, but neither I individual uncovered the problem. Id. at 1122-23. Hedreen intentionally failed to disclose the discrepancy, and the transaction closed two months later. Id. at 1123. Thereafter, Hedreen defaulted on the loan, and the bank filed an action against Hedreen for reformation of the master lease.[27]

---

27 Under Washington law, a party to a contract is entitled to reformation of the contract if one party is mistaken and the other has engaged in fraud or inequitable conduct. ' Hedreen, 886 P.2d at 1123. A party has engaged in fraud or inequitable conduct if it conceals a material fact from a party to which it has a duty to

Hedreen argued that it had no duty to disclose the error because both parties were sophisticated, had negotiated at arm's length and had an opportunity to review the master lease before signing it. Despite this, the court held that Hedreen had a duty to disclose the error because the parties had already agreed on the terms of the master lease. Id.

We believe that Hedreen is directly applicable here. Debtors entered into prior arm's length agreements (the earnest money and sale and purchase agreements) with Buyers to give clear title. The escrow instructions failed to reflect this understanding. Debtors were aware of the omission of Meridian's lien and, therefore, had a duty to disclose this fact to Buyers. Debtors breached this duty by failing to disclose the omission of Meridian's lien from the escrow instructions. Because reliance is established when a defendant withholds a material fact in the face of a duty to disclose, we hold that Buyers relied on the false

---

disclose. Id.

impression created by Debtors, silence.[28] Accordingly, because Rainier, as a subrogee and assignee of Buyers' rights, stands in the shoes of Buyers, we hold that Rainier has satisfied the reliance requirement of § 523 (a) (2) (A).

C. Damages

Lastly, as subrogee and assignee of Buyers' rights, Rainier must show that Buyers were damaged from Debtors' actions. Here, Buyers contracted for unencumbered property. Instead, they received property encumbered by a $65,000 lien. Accordingly, the damage element has been satisfied, and Rainier has met the requirements for a § 523 (a) (2) (A) nondischargeability claim.

II. Section 523 (a) (6)

Section 523 (a) (6) provides:

> (a) A discharge under section 727 of this title does not discharge an individual debtor from any debt--

---

28 Debtors contend that although they may have breached their contractual duty to disclose Meridian's lien to Buyers, § 523 requires that Debtors commit a tort before a debt becomes nondischargeable. Debtors, however, cite no law in support of this proposition.

. . . .

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity

11 U.S. C. § 523 (a) (6) (1995).

Rainier argued here and before the bankruptcy court that Debtors converted property of Buyers, thereby causing Rainier's loss. Debts for conversion are actionable under § 523 (a) (6) if the conversion was willful and malicious. Impulsora Del Territorio Sur. S.A. v. Cecchini (In re Cecchini), 780 F.2d 1440, 1443 (9th Cir. 1986). Conversion is the willful deprivation of another's property without lawful justification or excuse. Lewis County P.U.D. v. Washington Public Power Supply System, 705 P.2d 1195, 1211 (Wash. 1985). To establish conversion, it is essential that plaintiff show that the converted item is his property. In re Sanders, 105 B.R. 111, 113 (Bankr. M.D. Fla. 1989) (holding that once payments are made under a contract the money no longer belongs to the buyer).

Rainier contends that Debtors converted the $65,000 which should have-been used to satisfy Meridian's lien. This argument fails, because once Buyers delivered payment to

Debtors, they no longer owned the $65,000. Under the sale and purchase agreement, Buyers were required to pay Debtors $151,000 for the Property. Buyers did this and received the Property. Although Buyers did not receive the full benefit of their bargain, Debtors' actions did not constitute conversion.

However, Rainier successfully pled and proved actual fraud. Any underlying tortious injury that is willful and malicious will meet the § 523 (a) (6) standard. See Snoke v. Riso, 978 F.2d 1151, 1154 (9th Cir. 1992). Although Rainier did not argue actual fraud as a basis for its § 523 (a) (6) claim, it established Debtors' intentional, wrongful act in failing to disclose to Buyers and Rainier that the Property was not being transferred free and clear of the Meridian lien and the foreseeability of the loss resulting from Debtors" nondisclosure. In re Kirsh, 973 F.2d at 1457. Accordingly, the bankruptcy court should have granted summary judgment on Rainier's § 523 (a) (6) cause of action.

CONCLUSION

For the reasons set forth above, we AFFIRM the bankruptcy court's grant of summary judgment under § 523 (a) (2) (A) and REVERSE the bankruptcy court's denial of summary judgment under § 523 (a) (6).

APPENDIX F - MEMORANDUM (not for publication)[29]

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DEMAREST
v.
RAINIER TITLE

Defendants-Appellants.

Appeal from the Ninth Circuit Bankruptcy Appellate Panel
Russell, Hagan, and Ryan, Judges, Presiding

Argued and Submitted September 10, 1997
Seattle, Washington

Before: WRIGHT and SCHROEDER, Circuit Judges and SCHWARZER,[30] District Judge.

---

29 This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by 9th Cir. R. 36-3.

30 Honorable William W. Schwarzer, Senior United States District Judge for the Northern District of California, sitting by designation.

Debtors Stephen and Deborah Demarest appeal pro se the Bankruptcy Appellate Panel's ("BAP") decision in favor of Rainier Title Company ("Rainier"). We must decide whether the BAP properly affirmed the bankruptcy court's grant of summary judgment to Rainier, holding that the Demarests' debt to Rainier was nondischargeable under 11 U.S.C. § 523 (a) (2) because it was obtained by fraud.

To prove actual fraud under § 523 (a) (2) (A) , a creditor must establish: "(i) that the debtor made a representation; (2) the debtor knew at the time the representation was f false; (3) the debtor made the representation with the intention and purpose of deceiving the creditor; (4) the creditor relied on the representation; and (5) the creditor sustained damage as the proximate result of the representation." Apte v. Japra (In re Apte), 96 F. 3d 1319, 1322 (9th Cir. 1996) (citations omitted) These elements must be established by a preponderance of the evidence. See Grogan v. Garner, 498 U.S. 279, 291 (1991).

The issue in this case is reliance. The appellants' principal contention is that their nondisclosure that the deed of trust still encumbered the property could not have caused any justifiable reliance on the part of the

buyers.

Here appellants clearly knew that the buyers were acting without knowledge that they were receiving property that was encumbered. We held in Apte, indeed quoting the bankruptcy court's opinion in this very case, that "where an individual knows that another is acting without knowledge of material facts, the reliance element is satisfied by objective proof, i.e., whether a reasonable person might have considered the facts important to his or her decision." Apte, 96 F. 3d at 1323 (quoting In re Demarest, 176 B.R. 917, 922 (Bankr. W.D. Wash. 1995)). There is no question in this case that the existence of an encumbrance on the property would have been important to the buyers decision.

APPENDIX G - ORDER DENYING REHEARING (not for publication)

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DEMAREST
v.
RAINIER TITLE

Defendants-Appellants.

Before: WRIGHT and SCHROEDER, Circuit Judges and SCHWARZER, District Judge.

The panel as constituted above has voted to deny the petition for rehearing and to reject the suggestion for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35.

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.